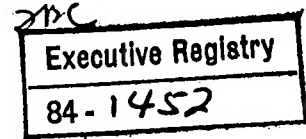




**UNITED STATES DEPARTMENT OF COMMERCE**  
**The Under Secretary for International Trade**  
Washington, D.C. 20230



HH. ER841399

March 26, 1984


The Honorable  
William J. Casey  
Director  
Central Intelligence Agency  
Washington, D. C. 20505

Dear Bill,

In addition to whatever use you may extract from the attachment, I would urge you to make two points to the silicon valley industry people.

1. The issue of Japanese quality vs. U.S. quality will not be resolved through rhetoric or public relations. If the U.S. industry cannot demonstrate equivalent or better quality it will see a continuing erosion of its market share in the U.S. The Defense Department's effort to bring to task companies who have failed to meet DoD specifications is an effort that we consider entirely appropriate and indeed should be redoubled.
2. Increasingly in Europe and the U.S. domestic companies are serving as a "trojan horse" for Japanese semiconductor and computer suppliers. That is, the Japanese companies such as NEC, Fujitsu, Hitachi have made arrangements to supply top-of-the-line computers and permit the domestic firms to affix their own labels. (Bob Gates' people have some good data on this.) We view this as a dangerous course in a national security context as well as in a commercial context.

Sincerely,

  
Lionel H. Olmer

Attachment



L-309

XF C-106

Address by  
Lionel H. Olmer  
Under Secretary for International Trade  
U.S. Department of Commerce  
Before the  
Commonwealth Club of California  
San Jose, California  
February 23, 1984

Trade with Japan and China: Impact on Silicon Valley

The Age of the Pacific is upon us. The focal point for many of our national interests, and the economic center of America's trade, has shifted dramatically from the Atlantic to the Pacific -- ending a 350-year tradition.

The long-term implications of this shift will affect our country's economy and each of you in Silicon Valley in ways now clear to us and in other ways not yet discernible.

When success stories about Silicon Valley are told, you expect adjectives like "brash," "aggressive", and "cocky."

One of your more humble residents, not given to understatement, is Jerry Sanders, founder and Chairman of Advanced Micro Devices. Jerry was quoted in a recent London Financial Times article as saying, "I believe we can grow next year -- more than we grew in our first 14 years." I think confidence and optimism about the future better describes the spirit of The Valley -- and this is indeed captured in Jerry's remark.

High-technology industries are the most dynamic part of the U.S. economy. And they are critical to U.S. economic growth, to our international competitiveness and to our national security.

They are propelled by sustained investment in research and development whose purpose is to create and introduce new products and processes. No ivory-towered intellectuals searching for purity in the abstract -- their commitment to costly scientific discovery derives from a maxim of successful business: knowledge and its application enable one company to be more competitive than another.

Most of these industries are also characterized by relatively high levels of exports. Note that:

- o Nine out of ten of the fastest growing U.S. industries in recent years have been high technology industries.

- o These industries have been a net deflator in our economy as their rate of price increases were only a third of those posted for overall U.S. inflation.
- o Labor productivity grew six times as fast as that of total U.S. business.
- o The benefits from high technology diffuse throughout the economy as innovation enhances product quality, reduces costs and increases productivity in other industries.
- o High technology represents an increasing proportion of our world trade and is a major positive contributor to our balance of trade.

Other nations and foreign entrepreneurs also perceive the seminal importance of high-tech and thus we are being challenged with greater intensity than ever before. Is your optimism warranted?

I want to discuss some of the problems created by foreign competition and the opportunities it creates. For even though your industry is booming in 1984, most of you remember only too well the pains inflicted by the recession. We should not forget that those who overlook the lessons of history -- said someone whose name I can't remember -- are condemned to repeat it.

Where will the U.S. industry be when the next slowdown occurs.

Reflect on the 1974 recession, when U.S. manufacturers cut-back their capacity, only to find themselves unable to meet the demands of succeeding boom years. They were forced to look on while aggressive marketing by Japanese competition resulted in significant lost sales and customers.

Staying ahead of competition is not a simple matter of designing the best product at the lowest cost. Among domestic impediments, your firms must also compete with a complex system of supports which foreign governments use to protect their domestic industries.

I am talking here about barriers and incentives such as investment restrictions, performance requirements and, what we've recently begun to identify as "targeting". This is a process by which a government can apply a relatively small subsidy in research and development, along with other types of financial, tax and regulatory support, that catapults an emerging industry beyond its competitors in other nations. It's not necessarily illegal or unfair or bad -- unless, of course you're on the losing end!

### Interdependence

Technology has made national economies mere fractional components of the world's trading system. Twenty-five percent of everything produced in the world is sold across boundries. Seventy percent of everything sold in America competes against products from other countries. Financing, production, and marketing increasingly take place on a worldwide basis.

Engineers and businessmen in Latin America and Asia have access to the latest technology, production techniques, and financing. Nations, therefore, create their own comparative advantage, not out of their natural endowments, but from knowledge and initiative.

We have also experienced the emergence of world joint ventures between private parties which transcend national economic policies. Two examples are the AT&T-Phillips agreement to sell digital switching equipment for telephone networks outside the U.S. and the IBM-Matsushita agreement to manufacture a Japanese personal computer to be built and sold in Japan.

Producers of computers and telecommunications components are linked through networks of technology-exchange agreements which include shared production of components, the manufacture of brand name devices for marketing under domestic identification, and the new phenomenon of cooperative research and development activities.

A product which combines communication and equipment technology could include a video display unit manufactured in Korea, a printer manufactured in Japan, components built in Malaysia, a disc drive manufactured in Singapore and a micro-computer made in the U.S.A.

### Trade in the U.S. Economy

In the U.S., exports now account for 20 percent of industrial production and 40 percent of our agricultural output. And, as everyone in this audience knows, I hope, exports create jobs -- a heck of a lot more than have been lost thru global interdependence.

Every billion dollars worth of exports creates about 25,000 new jobs in this country. In the past five years, more than 80 percent of the new jobs created in manufacturing -- a total of nearly 5 million -- were export-related.

A report by Business International Corporation demonstrates that "The greater the intensity of foreign investment the fewer jobs lost in the U.S.".

The study looked at an 11-year period of 55 manufacturers and 3 oil companies with worldwide sales of \$307 billion. Those firms investing most outside the U.S. increased employment in the U.S. 12.0 percent. Firms investing less outside the U.S. decreased employment in the U.S. 2.5 percent.

- Sales outside the U.S. grew nearly twice as fast as sales to U.S. customers (440 percent compared to 256 percent).
- The trade surplus was even more dramatic, rising by six-fold, from \$4.6 billion in 1970 to \$25.6 billion in 1981.

### Protectionism

We've never depended so much on exports as we do today for our economic growth. And yet, just when it's important for us to pursue open world trade, protectionist sentiment in the U.S. is growing -- certainly as measured by activity in the Congress where at least 89 pieces of protectionist legislation are pending.

Interdependence is stimulating fierce and sometimes unfriendly trade competition. The ripple-effects of which reach to the Legislature.

### Japan

Outside of Canada, Japan is America's biggest international customer, and the United States is Japan's biggest trading partner. Trade frictions are inevitable, given the dimension of our economic relationship.

The situation was summed up aptly by President Reagan in his recent speech to the Diet of Japan when he said that Americans believe that the Japanese market is less open than the Japanese believe.

America's trade deficit with Japan was \$19 billion last year, and \$8 billion of this was in electronic products. Since 1979, the deficit has grown larger each year and will increase again in 1984 to between \$25-28 billion.

In the past 30 years, a number of America's trading partners have targeted their infant industries. Because of the sheer size of the U.S. economy we could tolerate pressures resulting from these practices. But that is no longer true and I think we have reached a crossroads in world trade.

The U.S. no longer dominates. We're more sensitive to trade. We depend more on both exports and imports. And we cannot afford to be the shock absorber for world economic fluctuations.

Our trade deficit is enormous and growing. High tariffs are no longer the barriers they once represented to market access in the world or in Japan. For example, Japan has done an admirable job in reducing tariffs; but many other barriers remain.

We have been negotiating with Japan for the last three years. And we have made some progress.

In 1982 we formed the U.S.- Japan working group on high technology and it has achieved some important successes. The Japanese government has pledged: to encourage Japanese purchasers to buy more semiconductors from U.S. suppliers; to discourage the pirating of semiconductor products; to improve patent protection; and to provide U.S. manufacturers greater access to research and development activities in Japan.

The agreement follows nearly a year of intensive negotiations. It offers U.S. semiconductor manufacturers opportunities for increased sales that weren't previously available before to Japanese semiconductor users and to other industrial sectors.

Earlier this year, the Nippon Telephone and Telegraph Public Corporation (NTT) agreement between the U.S. and Japan was renewed and extended through December 31, 1986, with what we believe to be more benefits for U.S. firms.

NTT has agreed to improvements on procurement specifications, to the terms and conditions for standard contracts, and to the protection of proprietary information. On research and development, NTT has agreed to treat U.S. firms the same way it treats domestic companies.

The U.S. National Bureau of Standards (NBS) and NTT have signed an agreement which provides NBS with enhanced access to NTT technology which ultimately will help U.S. firms to develop downstream products for future NTT procurement.

We have made substantial progress. Nevertheless, old habits die hard -- on both sides. There are cynics in America who won't make the effort to succeed because they don't believe that the opportunities have increased. Despite sincere efforts of many at the top, we all know how bureaucracies can resist change. And we're facing that now, in respect to items of major concern.

- Proposed computer software legislation which may include authority for the trade ministry to compel the licensing of American technology in Japan, and a reduction in the time software may be protected from copying.

- Proposed legislation which may include a domestic content requirement for telecommunications services -- a new trade barrier to foreign firms.
- A satellite procurement policy which states that only domestically manufactured satellites may be purchased.

We are out on top of these issues and have expressed our disapproval in the strongest possible terms. I am optimistic that our views will prevail.

### Low-Tech

This is not an audience before which I should belabor the problems and opportunities of basic industries. But these industries are of enormous size -- here and in Japan. And, we are very competitive in many of them.

In late 1982, I visited Japan to better understand Japanese high-technology industries. I concluded that the government's role is pervasive, significant and unique

Last month, I returned to look at the structurally depressed industries such as petrochemicals, chemical fertilizers, pulp and paper. The government labels these "uncompetitive", and "depressed" partly because of high energy and raw materials costs and excess capacity.

In the U.S., depressed industries are strongly affected by increased imports. Not so in Japan. Similar to my previous findings in the high-tech area, I found extensive government-industry cooperation in Japan's depressed industries. Both government and industry groups work together to preserve a core industrial base.

Why do we need to know more about these industries? Because the U.S. is competitive in many of them. Even a small change in U.S. market share could appreciably improve our trade position with Japan.

I hasten to repeat that there is not necessarily anything wrong with this and many would say it's laudable. However, it is an important process for us to understand. First, these markets offer significant opportunities to U.S. business, second, and perhaps more important, government-business interaction in these industries is similar to that in the high-tech industries.

Our major concern is that this process must be more open and take into greater consideration the interests of foreign producers.

I have recommended that U.S. representatives be permitted to observe or even participate in the industrial structure councils where discussions take place on future directions of industry. I believe such a procedure will be worked out in the near future to our mutual satisfaction.

In November 1983, a group of American high-technology company officials, including Rubin Mettler of TRW, met a similar group of Japanese led by Mr. Marita of Sony. They concluded an agreement which commits the Japanese executives to provide greater opportunities for foreign suppliers to win sales contracts with their companies. At the same time, Americans are committed to making greater efforts to penetrate the Japanese market. No guarantees of more sales, and no starry-eyes. But it is a potentially useful instrument for growth.

#### Business Response

A New Year's Day story in the New York Times says "Few American chief executives possess any substantive experience in managing their international business in the Pacific Basin." That story should have been written on April 1! I don't believe it's accurate, but the perception has got to be turned around.

For many U.S. products, Japan is the largest single foreign market. Any firm that intends to be a world class competitor must have an active presence in this market. It's important for its own sake, as well as to give pause to Japanese efforts in the U.S. and third country markets.

American electronic companies are being given the opportunity to access the Japanese market. But they will need to:

- Establish a higher corporate priority for securing their earned share of the Japanese market, with an appropriate resource commitment to meet Japan's special market needs.
- Commit to long-term involvement in the Japanese market despite high start-up costs, and fulfill all the standards of performance which the Japanese expect on quality, price, delivery and service.
- Increase the personal involvement of high-level management in serving the Japanese market.
- Send corporate selling and investment missions to Japan and ask for your government's help in sponsoring such missions.

The firms which have been successful deserve great credit -- I understand what they have gone through. And I am confident that additional efforts by American high-technology firms to establish long-term relationships will also be successful.



## China

China offers huge opportunities for U.S. companies in many industry sectors. Here is a market not hobbled by debts, where U.S. exports are relatively low, and where there are tremendous possibilities for growth.

Peking has said it intends to sign contracts this year to import \$1 billion worth of advanced Western technology and equipment. We think they're very serious.

U.S.- China trade has experienced a number of ups and downs since diplomatic relations were normalized in 1979. The post-normalization euphoria gave way to pessimism when the Chinese abruptly cancelled most major projects because of economic difficulties, both internal and external.

Recently, bilateral relations have improved. A number of commercial agreements have been signed. U.S. companies have negotiated offshore exploration and development contracts for oil and gas, General Electric has sold diesel locomotives. Boeing and McDonnell Douglas have won substantial aircraft sales.

We've gotten off the roller coaster of expectations and discouragement to realistically evaluate the prospects for U.S.-China trade over the coming years.

The future of U.S.-China trade is bright and we are on the brink of a major expansion in our trade relationship.

In April, President Reagan will visit China, the first trip to China by an American President in nearly ten years. Last month, Chinese Premier Zhao Ziyang visited the United States. The highest ranking PRC leader ever to do so.

The President told Premier Zhao that his presence in the U.S. "symbolizes the growing trust and cooperation between our two countries", that it "is within our grasp to reap enormous rewards" from our friendship.

China has begun a vast modernization program to quadruple its economic output by the year 2000. The United States is now China's third largest trading partner, and American investment in China is over \$500 million -- exceeding that of all other countries. More than 100 U.S. firms have offices in China.

In addition, China does not have the foreign debt problems that plague most of the developing world. Chinese foreign exchange reserves are estimated at over \$15 billion and growing. And China is increasing its role in a stable and healthy East Asian economy.

### Developments in U.S.- China Relations

Solving trade issues between China and the U.S. has been a slow learning process -- for both sides, but we are solving or moving them closer to resolution.

Let me summarize:

In 1981, the President moved to liberalize controls on our "dual-use" exports to China. These are products and technical data which though specified for civilian use, could have significant military application. He determined that U.S. policy should "support a secure, friendly, and modernized China." Last year, the President directed that China be placed in the same group with other friendly countries for purposes of our export controls.

A major complaint of U.S. business toward our China policy was that our export controls took too long to process. Since the President's decision last May, much has been done to speed things up and to remove uncertainties.

We are substantially increasing the quantity and sophistication of exports to China. We will quadruple the number of approvals from 900 in 1983 to about 4,000 in 1984, by current estimates. But, there will be continuing trade problems with China.

The Chinese simply must gain a better understanding of our trade laws, which exist to protect American producers from unfair trading practices. Without our unfair trade laws, and effective enforcement, Congressional pressure for formal, severe forms of protectionism would be virtually impossible to withstand.

### China Adopts International Trade Practices

We are encouraged that the Chinese are increasingly adopting international trade practices.

Beginning with the Joint Venture Law of 1979, the Chinese have enacted laws to encourage trade and foreign investment.

The most striking example of Chinese flexibility and pragmatism was a willingness to tailor their foreign enterprise income tax law to ensure that taxes paid by U.S. oil companies in China would qualify for a foreign tax credit in the United States. The Chinese still have some way to go, but they are moving in the right direction.

To improve our commercial relations with China, we've tried to clarify the various rights of foreigners in China by signing a series of bilateral agreements covering trade, financial and transportation matters. At present, we are close to agreements involving income taxes, foreign investment, and nuclear cooperation.

President Reagan signed two protocols with Premier Zhao at the White House on January 12. One involved a five-year extension of our agreement on cooperation in science and technology. Since 1979, 21 separate protocols have been signed under this umbrella agreement in areas such as high-energy physics, hydropower development, and environmental protection.

A second agreement concerns industrial and technological cooperation. It will promote cooperation between our countries -- especially in those industrial sectors on which China puts priority -- such as coal, petroleum, transportation, telecommunications, and upgrading Chinese plants and equipment.

The PRC has placed top priority on upgrading their energy sector. U.S. companies have signed important contracts to assist China in developing its coal and offshore oil reserves. These projects will involve decades of work and tens of billions of dollars in equipment, technology and investment.

U.S. suppliers of transportation equipment, computers, instruments, chemicals and forestry products are all in an excellent position to do business in China.

China has shown great interest in American electronics.

The 3M Corporation has agreed in principle with Chinese authorities to establish the first venture in China to be wholly owned by a major foreign corporation. Previously, all foreign investment was on a joint-venture basis.

The 3M Corporation will be built a factory in Shanghai to manufacture products for telecommunications, electric power distribution, and electrical machinery.

Other priority areas for the Chinese include: Transportation, where the General Electric Company last November announced an agreement to supply China with 220 diesel electric locomotives. China needs very large railway purchases because they are double-tracking railroad beds and expanding electrification.

In the area of commercial aircraft sales to China, McDonnell Douglas signed a letter of intent to produce 25 commercial jetliners in China. This sale will be worth several hundred million dollars over the next six years.

### Conclusion

The challenges facing you in the Japanese and Chinese markets are quite different. But in seeking to break down existing trade barriers in Japan and in opening new doors to trade in China, two qualities are essential: armed with patience and perseverance you can achieve increasing U.S. exports and create jobs for American workers.

I think that the time has also come for our trading partners to understand what we in this country now clearly recognize: that we live in a highly interdependent global economy.

Markets are no longer national or regional. Our open market system requires our manufacturers to compete not only for customers overseas, but against robust foreign incursions into our domestic market as well. Automobiles, steel, textiles, cameras, and every kind of consumer product have swamped our shores. We cannot accept being excluded from those foreign markets whose firms enjoy profitable operations here. Nor can we tolerate practices which confer unfair competitive advantages. These must be uprooted.

President Reagan has resisted protectionism and has stressed his desire for an international trading system that is free and fair -- a system that will keep open the international channels through which the exchange of goods and ideas among nations will continue to expand.

Believe me that is not rhetoric.

The President recognizes the strains produced by the unprecedented expansion of world trade, by the explosive jump in our imports and by the resulting legacy of dislocations and hardship for many.

The President recognizes that virtually every nation is under severe domestic political pressure to protect its domestic markets from what they perceive as injurious competition.

Together, we will keep on the road to increasing trade and investment liberalization by demonstrating to the global trading community far and wide, that it truly is the only way to secure a healthy international economy.

Washington, D.C. 20505

Executive Registry

84 - 1399

27 March 1984

MEMORANDUM FOR: Chief, Technology Transfer  
Task Force

FROM: Director of Central Intelligence

SUBJECT: Draft Remarks to Commonwealth Club,  
Silicon Valley

This seems a little thin. Can you give  
me anything more specific that would be  
interesting for some comments on technology  
transfer at Silicon Valley.

C

William J. Casey



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DRAFT

DCI REMARKS TO  
COMMONWEALTH CLUB  
SILICON VALLEY  
3 April 1984

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